THE OFFICE OF REGULATORY STAFF

DIRECT TESTIMONY

OF

CAREY M. FLYNT

JUNE 25, 2008

DOCKET NO. 2008-4-G

ANNUAL REVIEW OF THE PURCHASED GAS ADJUSTMENTS AND GAS PURCHASING POLICIES OF PIEDMONT NATURAL GAS COMPANY

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IN RE: ANNUAL REVIEW OF PURCHASED GAS ADJUSTMENT AND GAS PURCHASING POLICIES OF PIEDMONT NATURAL GAS COMPANY, INC.

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Carey M. Flynt. My business address is 1441 Main Street, Suite 300, Columbia, South Carolina 29201. I am employed by the State of South Carolina as Manager of the Gas Department for the Office of Regulatory Staff ("ORS").

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a Bachelor of Science Degree in Business Administration, with a major in Accounting from the University of South Carolina in Columbia in May 1975. I was employed at that time in the electric and gas utility industry and gained twenty five years (25) experience in this field. In October 2004, I began my employment with ORS. I have testified on numerous occasions before the Public Service Commission of South Carolina ("Commission") in conjunction with natural gas issues.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to address the purchasing policies of Piedmont Natural Gas Company, Inc. ("Piedmont"), including the hedging program, the administration of Gas Cost Recovery Mechanism ("GCRM") and the Industrial Sales Program (ISP).

Q. WHAT IS THE REVIEW PERIOD FOR THIS PROCEEDING?

A. The review period is the twelve-month period April 1, 2007 through March 31, 2008.

Q. PLEASE DISCUSS PIEDMONT'S PURCHASING PRACTICES.

A. Piedmont must meet the demands of its firm customers on a peak day. Piedmont has firm transportation capacity on three (3) upstream interstate pipelines; including Transco, Columbia Gas and East Tennessee Transmission. The Company has firm contracted supply from multiple sources, storage service from the interstate pipelines and peaking liquefied natural gas ("LNG") quantities to meet its firm obligations. It is very important that the volume of gas needed for that peak day is available for the firm class of customers. It would be imprudent to plan for interruptible supplies to serve the Company's firm customers on a peak day. Natural gas customers, who utilize natural gas for heating their homes, cooking, water heating and other essential needs, expect the natural gas supply to be available. These firm customers have no alternate fuel capability and must have natural gas available 365 days a year.

Q. PLEASE DESCRIBE PIEDMONT'S SUPPLY CAPABILITIES.

A. For the 2007/2008 winter period, Piedmont had firm send out supply capability available for the Carolinas totaling 1,395,978 dekatherms. This supply included contracts with suppliers and contracted storage service on the Transco, Columbia and East Tennessee gas systems. Additionally, Piedmont had its own LNG facilities available, along with its contracted storage, to flow additional natural gas into the system when needed and to balance flowing supplies with system load requirements.

Q. WERE PIEDMONT'S CONTRACTED CAPACITY/DEMAND ENTITLEMENTS AND ITS PEAKING CAPABILITIES SUFFICIENT TO MEET THE REQUIREMENTS OF ITS FIRM CUSTOMERS?

A. Yes. For the winter period ending March 31, 2008, Piedmont had firm demand entitlements and peaking capabilities of 1,395,978 dekatherms, as compared to the System Design Day Firm demand requirements of 1,347,537 dekatherms. This analysis indicates the Company had adequate firm supplies to meet its firm customer's requirements. ORS recommends that the Company continue to monitor its firm supply capabilities with regard to future growth on the system and the many changes being experienced in the natural gas industry.

Q. DID ORS CONCLUDE THAT THE COMPANY ACTED PRUDENTLY IN PURCHASING SUPPLIES AND CONTRACTING FOR CAPACITY TO MEET THE REQUIREMENTS OF ITS FIRM CUSTOMERS?

A. Yes. The Company uses what they refer to as a "best cost" gas purchasing policy. This policy consists of five main components -- price, security, flexibility, and deliverability and supplier relations. These components are all interrelated and weighed on their importance. Piedmont has been very active in purchasing supplies directly on the market and making arrangements through interstate pipelines for the delivery of these supplies. ORS's observations of Piedmont's gas purchasing policies indicate that Piedmont is continuing its attempts to get the best terms available in its negotiations with suppliers. In addition, ORS believes Piedmont has used the spot market to prudently purchase supplies at prices competitive with industrial alternate fuels, as well as reducing costs to high priority customers. Also, Piedmont has been very active in FERC proceedings concerning rate changes by the interstate pipeline companies.

Q. WHAT WAS THE CONCLUSION ORS REACHED AS TO THE REVIEW OF PIEDMONT'S HEDGING PROGRAM?

A. Piedmont's original hedging program was approved by the Commission on March 26, 2002 in Order No. 2002-223 in Docket No. 2001-410-G. This order allowed for hedging up to sixty percent (60%) of the Company's natural gas supplies. On May 25, 2005 the Commission issued Order No. 2005-287 in Docket No. 146-G approving limited modifications to the hedging program in order to increase Piedmont's ability to utilize fixed-price instruments and complimentary options transactions in making both time-driven and price-driven hedges. Also, as stated in Mr. Sullivan's testimony, the Commission issued order No. 2006-527 in

Docket No. 2006-4-G which modified Piedmont's PGA or GCRM to reflect hedging activity results in the deferred account #253.04 on a monthly basis. For this annual review period, South Carolina customers incurred a net cost of $1,898,938 from the Company's hedging program. ORS determined that Piedmont managed its hedging program in a reasonable and prudent manner during the review period.

Q. DID ORS REVIEW THE COMPANY'S FORECASTED FUTURE REQUIREMENTS AND THE COMPANY'S STEPS TO MEET THIS DEMAND?

A. Yes. ORS reviewed the Company's forecasted future demand requirements and the activities the Company is taking to insure the reliability of these supplies. Piedmont has taken a number of steps in securing firm supplies for future demand on its system. These steps include negotiating with pipelines for capacity on the interstate systems, acquiring additional storage capacity, and negotiating contracts with suppliers. The Company plans to construct a new LNG facility with Maximum Daily Withdrawal Quantity (MDWQ) of 125,000MCF to be available in the 2012/2013 winter heating system. Piedmont has an obligation to maintain adequate supplies at just and reasonable costs to serve its customers. ORS found that the Company is prepared to meet this responsibility.

Q. PLEASE DESCRIBE PIEDMONT'S APPROVED GAS COST RECOVERY MECHANISM.

A. The purpose of Piedmont's GCRM is to permit the Company to recover the prudently incurred applicable actual cost of gas from its customers. The recovery of this cost consists of a two part cost of gas component consisting of a Demand cost of gas component and a Commodity cost of gas component. The Demand component includes all capacity charges for the transportation and storage of gas. The Commodity cost of gas component is comprised of charges for the volumes of gas purchased. Commodity charges are not associated with the capacity charges for transportation and storage. The GCRM provides that Piedmont establish a Benchmark Commodity Cost of Gas which is the Company's estimate or forecast of the City Gate Delivered Cost of Gas for gas supplies, excluding Demand Charges. The GCRM provides for the recording of the monthly differences between the actual cost of gas purchased and the rate billed to the customer into the Company's Deferred Account No. 253.04.

Q. DOES PIEDMONT'S APPROVED GAS COST RECOVERY MECHANISM ALLOW FOR ADJUSTMENTS TO THE BENCHMARK COMMODITY COST OF GAS?

A. Yes. The Benchmark Commodity Cost of Gas may be adjusted from time to time to recognize the current market price of gas. These requests are filed with the Commission and ORS for approval by this Commission. The GCRM also allows for the same type adjustment for the Demand Cost of Gas Component, although the Demand Component does not change as frequently as the Commodity Cost of Gas Component.

Q. WHAT IS THE CURRENT BENCHMARK COST OF GAS INCLUDED IN THE COMPANY'S RATES?

A. The current benchmark commodity cost of gas included in the company's rates is $11.50 per dekatherm which became effective with the first billing cycle of June, 2008. ORS does not recommend any change to the benchmark cost of gas at this time.

Q. HOW DO THE COMPANY'S GAS COSTS RECOVERY MECHANISM AND INDUSTRIAL SALES PROGRAM COMPARE TO THOSE OF THE OTHER GAS UTILITIES UNDER THE COMMISSION'S JURISDICTION?

A. Piedmont's GCRM and Industrial Sales Program are somewhat different than the operation for the one other South Carolina gas utility. The major difference is Piedmont has the opportunity to recover negotiated losses from its competitive industrial customers. Piedmont utilizes negotiated sales or transportation service to customers that would otherwise utilize alternate fuels because the maximum published rates may not be competitive at times. Due to the opportunity Piedmont has to recover negotiated losses through the operation of the deferred account, it is necessary that Piedmont negotiate its rate to industrial customers only to the level that is competitive with the alternative fuel prices without going below the Company's actual cost of the gas. Piedmont utilizes its monthly average cost of gas as the basis for negotiations of monthly sales service and will not negotiate a sales price that is lower.

Q. DID ORS FIND THAT THE COMPANY HAS BEEN NEGOTIATING A PRICE WITH THE INDUSTRIAL CUSTOMER ONLY TO THE LEVEL WHICH IS COMPETITIVE WITH THE ALTERNATE FUELS AND NOT BELOW THEM?

A. Yes. When Piedmont is negotiating its rate to compete with alternate fuels, the Company ensures three objectives are met. These are:

- The quoted rate does not undercut the cost of the alternate fuel;
- The most accurate market prices are utilized for both alternate fuels and natural gas; and
- Negotiating the highest possible margin.

The first step to ensure that Piedmont does not undercut alternate fuel prices is to identify the reasonable range of costs for specific alternate fuels early in the negotiation process. A number of alternate fuel prices are identified by Piedmont's account representatives and entered into an online database. Both Piedmont management and account representatives have real time access to these alternate fuel prices in a format that allows the comparison of prices from various customers and various locations across the service area. The comparison of these customer alternate fuel costs allows Piedmont to identify the range of market prices of various types of fuel and to identify customer submitted alternate fuel prices that do not fall in an expected cost range. Piedmont contacts these customers again and requests verification of alternate fuel prices when the prices supplied by the customer are lower than expected.

Additional resources are available to identify the market pricing for alternate fuels. These resources include various Internet sites such as the Energy Information

Administration, NYMEX, Amerada Hess, WTRG Economics, Industrial Fuel, Enline Energy, Horizon Energy, and Oil Energy.

When Piedmont is negotiating its transportation rate, Piedmont utilizes two sources to understand the market cost of gas provided by a third party marketer. These sources include NYMEX for the commodity cost and internal gas supply personal to identify a reasonable basis cost. If the Company thinks quoted total delivered price for natural gas is excessive, the Company will offer a negotiated price based on what the company thinks is reasonable.

It is important to understand that Piedmont's approved negotiating process does not allow the Company to retain all loads each month, but it does allow the Company the opportunity to provide natural gas sales and transportation service to avoid lost sales in the market place.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.